NO. 96383-5

SUPREME COURT
OF THE STATE OF WASHINGTON

LOWE'S HOME CENTERS, LLC,

Petitioner,

v.

DEPARTMENT OF REVENUE,
STATE OF WASHINGTON,

Respondent.

MEMORANDUM OF AMICUS CURIAE COUNCIL ON STATE TAXATION IN SUPPORT OF PETITIONER

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I. STATEMENT OF INTEREST OF AMICUS CURIAE

The Council On State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. Its membership consists of approximately 550 of the largest multistate corporations engaged in interstate and international business and represents industries doing business in every state across the country. Its objective is to preserve and promote the equitable, non-discriminatory state and local taxation of multijurisdictional business entities.

COST supports Lowe's Home Centers, LLC ("Lowe's") in this case because it will impact sellers' ability to fairly obtain credit for sales taxes remitted to the State that ultimately were not paid by a purchaser and for which the seller remains responsible. As forced tax collection agents for the State, when a purchaser fails to remit the full amount due, sellers should be able to obtain credit for a portion of the sales tax remitted to the state upon which the purchaser did not pay.

COST also supports Lowe's because the Court of Appeals' approach threatens inconsistency in the interpretation and administration of the B&O tax bad-debt deduction under RCW 82.04.4284, which could harm COST's members, especially those that report B&O tax under more than one classification.

In addition, Washington is a full member of the Streamlined Sales and Use Tax Agreement ("SSUTA"), and this case will create a precedent for how the other 22 full-member states will provide bad-debt relief in cases with similar facts. COST's members, many of whom conduct a substantial amount of business in Washington, are directly impacted by this case.

As amicus, COST has participated in numerous significant federal and state tax cases over the past 40 years, including many filings in Washington. In this memorandum, COST highlights the importance of the State's bad-debt provision and why this Court should review the Court of Appeals' decision to reject a bad-debt deduction—even though the seller was entitled to claim it under the federal Internal Revenue Code. *See* 26 U.S.C. Sec. 166 ("IRC § 166").

II. STATEMENT OF THE CASE

COST generally adopts the Statement of the Case as framed by Lowe's.

COST asserts the plain reading of Washington's bad-debt law under RCW 82.08.037 in effect for the tax periods at issue clearly allows a seller to claim a bad debt for sales tax. A complimentary provision, RCW 82.04.4284, similarly allows a bad-debt deduction for the State's B&O tax. Specifically, in part, RCW 82.08.037(1) provides:

> A seller is entitled to a credit or refund for sales taxes previously paid on bad debts, as that term is used in [IRC § 166], as amended or renumbered as of January 1, 2003.

Lowe's was the "seller" that "previously paid" the sales tax on which it realized a bad debt pursuant to IRC § 166.

Importantly, this provision also conforms with Section 320 of the SSUTA[1] which, in part, provides:

> Each member state shall use the following to provide a deduction for bad debts to a seller. To the extent a member state provides a bad debt deduction to any other party, the same procedures will apply. Each member state shall:
>
> A. Allow a deduction for taxable sales for bad debts. Any deduction taken that is attributed to bad debts shall not include interest.
>
> B. Utilize the federal definition of "bad debt" in [IRC § 166] as the basis for calculating bad debt recovery. However, the amount calculated pursuant to [IRC § 166] shall be adjusted to exclude: financing charges or interest; sales or use taxes charged on the purchase price; uncollectable amounts on property that remain in the possession of the seller until the full purchase price is paid; expenses incurred in attempting to collect any debt, and repossessed property.
>
> C. Allow bad debts to be deducted on the return for the period during which the bad debt is written off as uncollectable in the claimant's books and records and is eligible to be deducted for federal income tax purposes.

[1] *See* Streamlined Sales and Use Tax Agreement (as amended May 3, 2018), *available at* http://www.streamlinedsalestax.org/index.php?page=modules.

Nothing in this section of the SSUTA implies, or requires, the debt for each specific debtor be on the actual books and records of the seller. Rather, consistent with RCW 82.08.037, it clearly only requires that the claimant has written off the debt on its books and records to be eligible for a bad-debt deduction. Lowe's has, as a guarantor of the debt, fully complied with the statute and, therefore, should be eligible to claim a bad-debt deduction for federal income tax purposes. Providing such a deduction for bad debts realized by sellers also comports with good sales tax policy, which the Washington State Legislature has demonstrated it supports via its full membership in the SSUTA.

III. ARGUMENT

A. The Court of Appeals' Rationale for its Decision is Contrary to the Plain Meaning of the Statute.

COST strongly agrees with the Dissent in the Court of Appeals that the majority's holding conflicts with the "plain language" of the law. *Lowe's Home Ctrs., LLC v. Dep't of Revenue*, 5 Wn. App. 2d 211, 245, 425 P.3d 959, 975 (2018) (Maxa, C.J., dissenting). This Court should correct the lower court's holding as it placed improper weight on the dicta used in the *Home Depot* case. *See Home Depot USA, Inc. v. State Dep't of Revenue*, 151 Wn. App. 909, 215 P.3d 222 (2009). That case and its fact patterns are very different from those present in the *Lowe's* case before this Court. The Court of Appeals did not thoroughly vet the facts and

appears to have misunderstood Lowe's agreement and its relationships with GE Capital Financial Inc. and Monogram Credit Bank of Georgia (collectively "the Banks"), discussed in more detail below.

As stated above, Washington's sales tax laws governing bad debts under RCW 82.08.037 are written to justifiably provide relief to sellers that remit sales tax on a transaction that purchasers ultimately fail to fully pay.

RCW 82.08.037 is a straightforward law; under the plain, unambiguous meaning of that statute, Lowe's is entitled to retail sales tax credits based on the payments it made as the *guarantor* of debt obligations arising from Lowe's credit card accounts. This is a critical fact difference from the *Home Depot* case. There is no dispute over whether Lowe's promptly remitted to the Department of Revenue all Washington sales and B&O taxes on the private label credit card transactions. And there is no question that Lowe's appropriately applied RCW 82.08.037 to deduct its "bad debts" under IRC § 166.

The lower court, using dicta from *Home Depot*, asserted the bad debts for which Lowe's was responsible were not debts on "sales tax previously paid" because Lowe's initially received payment on the gross proceeds for retail sale private label credit card (PLCC) transactions. The lower court place emphasis on the seller having received "initial

payment," even though doing so has no basis in RCW 82.08.037. Thus, the lower court arbitrarily bifurcated the initial payment and inappropriately labeled the transaction between Lowe's and the Banks as the "profit-sharing [of] bad debts." *Lowe's*, 5 Wn. App. 2d at 225, 425 P.3d at 966.

It is important to point out, however, that the key facts in this case are substantially different from the facts in *Home Depot*. As summarized by the dissent in the Court of Appeals decision:

> Under its agreements with the Banks, Lowe's acted as the guarantor of those bad debts up to a capped amount. In other words, Lowe's had a contractual obligation to pay the Banks the amount of the Banks' bad debt losses, which included sales taxes and B&O taxes.
>
> Lowe's claimed sales tax credits and B&O tax deductions for the payments it made as the guarantor of the Banks' bad debts. Lowe's also deducted those losses on its federal income tax returns.

Id., 5 Wn. App. 2d at 243-44, 425 P.3d at 975 (Maxa, C.J., dissenting).

Importantly, unlike Home Depot which did <u>not</u> guarantee the debt on Home Depot credit cards, Lowe's *did* guarantee debt obligations arising from its credit card accounts. Since the *Home Depot* facts did not involve a guarantee of debt, the *Home Depot* court limited its analysis to the fact Home Depot was paid in full on Home Depot credit card

transactions. No continuing debt existed in the *Home Depot* case for the court to determine whether debt on sales taxes previously paid existed.[2]

In the current case, however, Lowe's, at all relevant times, remained responsible for bad-debt losses for transactions on which sales tax was previously remitted by Lowe's. These debts were not from an unrelated profit-sharing agreement between Lowe's and the Banks. Instead, the debts were related to transactions between Lowe's and its customers that prompted the remittance of both sales taxes and B&O taxes. Thus, according to the plain meaning of the statute, the taxes "previously paid" on Lowe's bad debt entitles Lowe's to credits for those paid taxes.

B. The Decision Below Introduces an Unwarranted and Inconsistent Application of the B&O Tax Bad-Debt Deduction.

Given the breadth of COST's membership in all business activities, COST also has a special interest in avoiding a misinterpretation of the B&O tax deduction for bad debts, which applies not just to retailers but to all classifications of business subject to B&O tax. The Department's very oblique "plain-meaning" argument, *see* Resp. Supp. Br. at 6 (citing *Dep't of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 43 P.3d 4 (2002)),

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[2] While amicus fully supports a bad-debt deduction in the *Home Depot* fact pattern as a matter of sound tax policy, it is understood that an expansion of the State's bad-debt credit under the *Home Depot* case circumstances will likely require legislative action by the Legislature.

places reliance on the word "debt" in other sales tax administration statutes. *See id.* at 6-7 (citing RCW 82.08.050(1)). The technical mechanisms of sales tax collection are irrelevant to interpreting the B&O tax deduction. The fact that both the sales and B&O tax statutes refer to the Internal Revenue Code's bad-debt provision, IRC § 166, shows that *it* is the relevant "closely related statute" for purposes of *Campbell & Gwinn*'s plain-meaning analysis, not RCW 82.08.050(1).

RCW 82.04.4284(1) provides a B&O tax deduction as follows: "In computing tax there may be deducted from the measure of tax bad debts, as that term is used in 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003, on which tax was previously paid."

The ***only*** criteria for eligibility for this deduction are (1) the accrual of "bad debts" as understood in IRC § 166 and (2) prior payment of B&O tax on the amounts later qualifying as "bad debts." Nothing in this text implies anything about the character of the commercial relationship between the taxpayer and its customers.

To illustrate the disconnect between the treatment of retailers and other types of businesses for B&O purposes threatened by the decision below, consider the following example of a Washington-based producer of computer software. Such a producer is taxed as a "manufacturer" when it sells prewritten software for delivery in China to a hardware manufacturer

or a software retailer. *See* WAC 458-20-15502(3)(d). The measure of the tax is the value of the products, as evidenced by gross proceeds of sale. *See* RCW 82.04.240; 82.04.450. If the producer uses the accrual method of accounting, it pays the tax when it accrues the right to payment. *See* WAC 458-20-199.

Suppose, to ease the international remittance from the foreign buyer and/or to control for currency or political risks, the parties arrange for payment via a direct-pay letter of credit ("L/C"). The L/C constitutes a loan by a financial institution to the foreign buyer. However, suppose also that the L/C issuer is unwilling to bear the entire credit risk of the foreign purchaser's nonperformance under the L/C reimbursement agreement, and the software producer agrees to a "claw-back" of some portion of the payments under the L/C in the event of the borrower's default.

The software producer has paid B&O tax when it accrued the right to payment. If the producer later has to repay the bank a portion of the L/C proceeds because of a reimbursement default or other impediment to the foreign customer's repayment of the bank, the software producer is entitled to take the B&O tax deduction. Its payment back to the bank is a discharge of a guaranty and is therefore an eligible bad debt under IRC § 166. *See* 26 C.F.R. § 1.166-9(a); *see also* Pet. Supp. Br. at 13-14 (discussing same).

The integrity of statutory interpretation in this case depends on a sensible interpretation of the B&O statute. In the illustration above, the software manufacturer is not paying a "selling" tax under the B&O tax code, and nothing in RCW 82.04.4284 restricts the bad-debt deduction to "sellers." Nothing in the Department's architecture of restrictions on the sales tax credit applies in such a case: (1) arguably there was no direct indebtedness of the foreign purchaser in favor of the software producer, *cf.* Resp. Supp. Br. at 7, 10; (2) the software producer did not pay the buyer's sales tax but rather its own B&O tax, *cf. id.*; (3) there was not necessarily an assignment of the reimbursement agreement (i.e., an "account") by the L/C issuer to the software producer, *cf. id.* at 12. But the B&O tax deduction statute is not, by its express terms and plain meaning, limited by any of these supposed restrictions. The software producer's eligibility for the B&O tax deduction is simple and straightforward. And, the sales tax bad-debt credit for Lowe's should be similarly interpreted in this straightforward manner to allow the credit.

Therefore, the decision of the Court of Appeals is fatally flawed by the court's adoption of extra-statutory requirements for the sales tax credit, based entirely on the word "seller" in the sales tax statute, because it would also undermine uniformity in application of the B&O tax deduction

across classifications and create inconsistency between the two statutes. This incoherence could not have been the Legislature's intent.[3]

C. This Court's Interpretation of Washington's Sales and Use Tax Bad-Debt Provision Must be Consistent with SSUTA's Bad Debt Provision

Washington has been a full member of the SSUTA since July 1, 2008.[4] As written, Washington's bad-debt law, RCW 82.08.037, is in compliance with Section 320 of the SSUTA. However, the Court of Appeals' decision casts doubt on Washington's compliance with the SSUTA by stating a contractual arrangement with a third party always prevents a seller from obtaining a bad-debt credit. The SSUTA realized early on that it needed to address bad debts: "The development of a uniform allowance for bad debts was on the original list of uniformity features designated as necessary for the development of a streamlined sales and use tax system, which was provided to the Project by the National Governors Association (NGA), National Conference of State Legislatures (NCSL), Multistate Tax Commission (MTC), and the

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[3] Note also that the legislative repeal of *Puget Sound Nat'l Bank v. Dep't of Revenue*, 123 Wn.2d 284, 868 P.2d 127 (1994), by Laws of 2010, 1st Spec. Sess. ch. 23 did *not* limit the B&O tax bad-debt deduction in the same way. This divergence in legislative treatment confirms that the essential criteria shared by both statutes are just two: 1) that the taxpayer paid the tax and 2) suffered a deductible bad debt *for federal tax purposes* on account of the taxed transaction or activity.

[4] *See* https://www.streamlinedsalestax.org/index.php?page=washington.

Federation of Tax Administrators (FTA) at its initial meeting in March, 2000." *See* Streamlined Sales Tax Project Issue Papers, November, 2001.[5]

The SSUTA bad-debt provision has two key provisions for a seller to claim a sales and use tax deduction: 1) the bad debt meets the criteria of a bad debt pursuant to IRC § 166, with some exclusions that are not relevant to this case (*see* SSUTA § 320(A) & (B)); and 2) the bad debt must be written off as uncollectable in the claimant's books and records (SSUTA § 320(C)). *Id.*

In addition to conforming to the bad-debt requirements in Washington's law, Lowe's has met the SSUTA § 320 requirements to claim a bad-debt deduction. It is not disputed that: 1) the bad debts can be claimed by Lowe's as an IRC § 166 deduction for a bad debt; and 2) as a contractual guarantor of the bad debt it is liable for that debt up to an agreed-upon cap, which was written off as uncollectable in its books and records.

Washington's participation in the SSUTA has made it easier for sellers to collect and remit Washington's and other member states sales and use taxes. This is especially important after the U.S. Supreme Court's decision in *South Dakota v. Wayfair, Inc.,* 138 S. Ct. 2080 (2018), which

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[5] The November, 2001 Issue Papers document is available at: https://www.streamlinedsalestax.org/docs/default-source/issue-papers/issue-papers-for-2001.pdf?sfvrsn=84a2198f_4.

expanded the states' ability to require sellers not physically present in a state to collect and remit the state's sales and use taxes. South Dakota's membership in the SSUTA and the SSUTA's uniformity provisions were specifically mentioned as an important feature by the Court. The Supreme Court stated with approval that "more than 20 States [] have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs . . . ." *Id.* at 2100.

This Court now has the opportunity to correctly interpret Washington's bad-debt provision to be consistent with the SSUTA bad-debt provision. This will avoid causing a disruption in the multistate uniformity that sellers rely on and that Washington's legislature has supported. Indeed, RCW 82.08.037(6) requires allocation of bad debts among member states, and the decision below would disrupt that uniform allocation by establishing an outlier criterion for eligibility.[6]

While Washington, according to the express terms of the SSUTA, remains sovereign to impose and interpret its sales and use tax laws (and B&O tax laws), the State could be subject to sanctions if it is determined that that Washington is not in substantial compliance with the SSUTA's

[6] Oklahoma is another full-member SSUTA state. While the underlying calculation to claim the bad-debt credit is disputed in Oklahoma, *see Sales and Use Tax Protest of Lowe's Home Ctrs., LLC v. Oklahoma Tax Comm'n,* No. 117,119 (Okla. Court of Civil Appeals March 4, 2019), the court did not disturb the findings of an administrative law

bad-debt provision. Initial sanctions are usually set to encourage the State's legislature to put the State back into compliance with the SSUTA's terms; however, they can progressively lead to a state being expelled as a member state to the SSUTA.[7] This possibility highlights the importance of this Court's careful consideration of how the bad-debt credit applies to sellers in Washington.

D. Allowing Sellers to Claim Bad-Debt Deductions is Sound Sales Tax Policy.

In January 2015, COST's non-profit research affiliate, the State Tax Research Institute ("STRI"), published a report on the sales tax policy considerations for allowing bad-debt deductions relating to private label credit card defaults.[8] As noted in the report, "Best practice structures sales taxes in all states so that the tax base approximates *paid* consumption, though states differ legally whether the sales tax is levied on consumer expenditures or business receipts." *Id.* at p. 2 (emphasis in original). The report outlines four sound tax policy principles for the application of

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judge that Lowe's was legally entitled to a bad-debt credit. The dispute focused on the calculation and evidence needed to obtain the credit.

[7] *See* SSUTA §§ 320 (bad-debt provision), 803 (state annual recertification of compliance with the SSUTA), 805 (substantial compliance requirement), 805.1 (compliance review process), 809 (sanctions of member states), 1101 (cooperating sovereigns), 1002 (state law controls), and 1003 (limited binding and beneficial effect).

[8] William F. Fox, State Tax Research Institute, *Sales Tax Policy Considerations for Private Label Credit Card Defaults* (2015), *available at* https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/sales-tax-policy-considerations-for-private-label-credit-card-defaults.pdf.

refunding sales taxes remitted by sellers on behalf of customers when a purchase-financing arrangement results in a bad debt.

First, sales tax should be based on paid consumption, and a default on a taxable payment includes a sales tax component. Second, seller-issued credit cards should not be afforded preferential treatment over other third-party credit cards; both should be treated neutrally by the law and permitted the deduction. Third, the state should not reap the benefit of a tax when a purchaser fails to repay the credit it was afforded by a seller. Fourth, allowing such refunds creates a more level playing field, and does not arbitrarily provide certain sellers advantages based on the type of purchaser financing they choose to use. *Id.*

Limiting the State's bad-debt credit for non-statutorily expressed reasons is inconsistent with sound tax policy.

IV. CONCLUSION

The facts in this case are "completely different" from *Home Depot's* fact pattern. *Lowe's,* 5 Wn. App. at 246, 425 P.3d at 976 (Maxa, C.J., dissenting). Lowe's, as the guarantor of the debt, booked the bad debt, which it was then allowed to claim under IRC § 166. This method of booking bad debt complies with RCW 82.08.037 for sales and use tax purposes and RCW 82.04.4284 for B&O tax purposes—highlighting this Court's need to reverse the majority decision of the Court of Appeals.

For the foregoing reasons, COST respectfully requests that the Court reverse the Court of Appeals' decision and grant Lowe's the ability to claim a bad-debt credit under RCW 82.08.037 and the bad-debt deduction under RCW 82.04.4284.

RESPECTFULLY SUBMITTED this 12th day of April, 2019.

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April 12, 2019 - 2:26 PM

Transmittal Information

Filed with Court:	Supreme Court
Appellate Court Case Number:	96383-5
Appellate Court Case Title:	Lowe's Home Centers, LLC v. Department of Revenue, State of Washington
Superior Court Case Number:	15-2-02994-8

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